

**COMMONWEALTH OF MASSACHUSETTS
DEPARTMENT OF PUBLIC UTILITIES**

Investigation by the Department of Public Utilities)
on its own Motion into Rate Structures that will)
Promote Efficient Deployment of Demand Resources) D.P.U. 07-50

INITIAL COMMENTS OF RETAIL ENERGY SUPPLY ASSOCIATION

Introduction

The Retail Energy Supply Association (“RESA”) is a nonprofit organization and trade association that represents the interests of its members in regulatory proceedings in the Mid-Atlantic, Great Lakes, New York and New England regions. RESA’s members include providers of competitive supply products to electricity and gas consumers in the five New England states – including Massachusetts – that have restructured their electric markets.¹

On June 22, 2007, the Department of Public Utilities (“Department” or “DPU”) issued a Vote and Order Opening Investigation (“Order”) into alternative rate and recovery structures that may reduce disincentives for electric and gas utilities to promote energy efficiency and other demand resources.² The Order reflects the Department’s concern that once base rates are established in a rate proceeding using a test year level of

¹ RESA’s members include Commerce Energy, Inc; Consolidated Edison Solutions, Inc; Direct Energy Services, LLC; Gexa Energy; Hess Corporation; Integrys Energy Services, Inc.; Liberty Power Corp.; Reliant Energy Retail Services, LLC; Semptra Energy Solutions; Strategic Energy, LLC; SUEZ Energy Resources NA, Inc.; and US Energy Savings Corp. The comments expressed in this filing represent the position of RESA as an organization but may not represent the views of any particular member of RESA.

² Vote and Order Opening Investigation, June 22, 2007, Docket 07-50.

sales, utilities have strong incentives to increase sales and avoid decreasing sales even though the public interest may be furthered by initiatives that cause the latter result, such as expanded customer use of energy efficiency measures and demand response programs.³ To set the stage for the Department's investigation, the Order introduces a straw proposal ("Proposal") that is designed to remove any utility disincentives to support investment in demand resources by decoupling its distribution revenues from sales volumes ("Revenue Decoupling" or "RD").⁴ The Order invites interested persons to submit general comments on issues within the docket, as well as on more than a dozen specific questions.⁵ It also invites interested parties to participate in panel discussions at public hearings to be held in the upcoming months.⁶

RESA is pleased to offer the following general comments on the important legal and policy issues raised in this docket.⁷ As discussed below, RESA supports the pro-efficiency and pro-conservation goals articulated in the Order but questions whether Revenue Decoupling in general and the Proposal in particular are the best available – or even workable – mechanisms for achieving them. Simply put, RESA is skeptical as to whether the Proposal can and will generate enough benefits to offset the high costs of implementing and administering it and the risks of unintended adverse consequences associated with a radical departure from decades-old utility ratemaking principles. RESA requests that the Department carefully consider the benefits, costs and risks associated

³ Id. at 1-2.

⁴ Id. at 10-19.

⁵ Id. at 19-22.

⁶ Id. at 23-24; see also Department Memorandum, August 9, 2007, Docket 07-50 (rescheduling the first set of public hearings to the weeks of October 22, 2007 and October 29, 2007).

⁷ RESA will not respond to specific questions enumerated in the Order at this time.

with Revenue Decoupling before electing to implement the Proposal or other RD mechanisms.

RESA is also concerned that the massive administrative effort associated with consideration and, if adopted, implementation of Revenue Decoupling will divert attention from policy initiatives that will directly benefit Massachusetts business and residential customers and further the societal goals reflected in the Orders, including implementation of dynamic pricing for basic service customers and reforms to foster distributed generation (“DG”). RESA urges the Department to remain focused on these and other non-RD policy initiatives that will benefit consumers and serve broader goals, irrespective of whether any form of Revenue Decoupling is implemented at the conclusion of this proceeding.

Overview of the Purpose and Structure of the Proposal

The Order states that greater deployment of energy efficiency, demand response and DG are crucial to the advancement of state, regional and national policies for the electricity and natural gas markets and their environmental impacts.⁸ In particular, the Order observes that expanded use of these resources could: (1) lower electricity and gas bills for customers who conserve energy; (2) drive down electricity costs for all customers by improving the efficiency and price-responsiveness of wholesale electricity markets; (3) mitigate the social and economic risks associated with climate change; and (4) minimize the environmental impacts of energy production, transportation and consumption.⁹

⁸ Order, pp. 1-2.

⁹ Id. at 2.

The Department believes, however, that the current utility rate structures and recovery mechanisms undermine these goals because they encourage the utilities to maximize sales volumes between rate cases in order to recover their costs and provide a robust return to their shareholders.¹⁰ Because energy efficiency and other demand resources will always reduce volumetric sales, the Department believes that utilities have a structural disincentive to promote them.¹¹ Thus, the overarching objective of the Proposal is to remove that disincentive and pave the way to greater use of demand resources in the Commonwealth.¹²

The Proposal attempts to achieve this goal by introducing a new rate structure that would render the utilities' distribution revenues immune from changes in sales volumes between rate proceedings.¹³ Under the Proposal, the utilities would be guaranteed a fixed allowed revenue amount for each customer they serve during a twelve-month recovery period, irrespective of changes to the customer's electricity or gas usage.¹⁴ The allowed revenue per customer would be determined for each rate class in the utility's base rate proceeding to ensure that the resulting rates are just and reasonable and not unduly discriminatory or preferential to any rate class.¹⁵ The allowed revenue per customer would not change between rate proceedings.

¹⁰ Id.

¹¹ Id. at 3.

¹² Id.

¹³ Id.

¹⁴ Id. at 13-14.

¹⁵ Id. at 10, 14.

Although the Proposal would guarantee the utilities a fixed allowed revenue per customer, the customers would be charged distribution rates that vary with their energy usage and demand, consistent with present practice.¹⁶ To enable the utilities to receive their guaranteed recovery, the Proposal provides for an annual reconciliation of the actual revenues collected from customers to the allowed revenues, yielding a true-up charge or credit that would be added to or deducted from future distribution rates to be assessed to customers.¹⁷

Prior to each twelve-month recovery period, the utilities would compute, for each rate class, the targeted level of allowed revenues to which they will be entitled, along with the projected distribution revenues that will be collected from customers during the prospective recovery period.¹⁸ The difference between the targeted allowed revenues and actual revenues projected for each rate class would be added to or deducted from the distribution base energy rate to be assessed to customers during the prospective recovery period.¹⁹ This adjustment, together with the true-up adjustment described above, would be subject to Department approval.²⁰

¹⁶ Id. at 3.

¹⁷ Id. at 14.

¹⁸ Id. at 15.

¹⁹ Id.

²⁰ Id. at 16.

General Comments on Revenue Decoupling and the Proposal

I. THE DEPARTMENT SHOULD CAREFULLY EVALUATE POTENTIAL BENEFITS, COSTS AND RISKS ASSOCIATED WITH ANY REVENUE DECOUPLING MECHANISM.

A. Introduction.

The Department is one of several state Commissions that recently have elected to investigate Revenue Decoupling as a potential mechanism for fostering increased investment in cost-effective policy measures, including conservation and load management, demand resources and DG.²¹ While Revenue Decoupling has intuitive appeal (i.e., all other things being equal, one would expect that removing structural disincentives should lead to increased investment), many industry experts, interest groups and state policymakers have rejected RD on legal, policy and practical grounds. For example:

- The National Association of State Utility Consumer Advocates (“NASUCA”) recently issued a Resolution opposing Rate Decoupling as a mechanism for fostering societally-beneficial investment. The Resolution posits, among other things, that: (1) RD shifts excessive risks from the utilities’ shareholders to its ratepayers; (2) increases electricity costs to consumers; and (3) is generally not needed to motivate the utilities to promote energy conservation and efficiency.²²
- The Electricity Consumers Resource Council (“ELCON”) recently released a Policy Brief that opposed RD because it: (1) shifts risks to ratepayers; (2) promotes mediocrity in utility management; (3) paradoxically hinders the use of efficiency and load reduction programs by rewarding customers who engage in these measures

²¹ See Another Side to Decoupling: Share the Gain, Not the Pain, Public Utilities Fortnightly, August, 2007, p. 46 (stating that proposals to adopt RD are pending in at least 11 states).

²² NASUCA Energy Conservation and Decoupling Resolution, June 12, 2007 (hereinafter “NASUCA Resolution or “Resolution”), available at <http://www.nasuca.org/res>. Massachusetts abstained from voting on the Resolution.

with higher distribution rates (in the form of a true-up mechanism), while producing bill credits for those who have excessive consumption; and (4) is inferior to other measures that would foster increased energy conservation and efficiency.²³

- Finally policymakers in Arizona, Nevada, Minnesota and other states have rejected RD proposals on various legal and policy grounds, and earlier RD experiments in Idaho, Montana and Maine all proved unsuccessful as unforeseen events, such as economic downturns, produced unintended, adverse consequences for customers.²⁴

RESA does not have a firm position at this time as to whether Revenue Decoupling in general or the Proposal specifically should or should not be implemented by the Department. Nevertheless, RESA believes that many of the arguments raised by opponents of RD, including those discussed below, potentially have merit. RESA therefore urges the Department to carefully consider and weigh these opposing views as it proceeds with its investigation.

B. Revenue Decoupling May Not Yield Expected Benefits.

While the fundamental purpose of Revenue Decoupling is to remove disincentives to utility investment in conservation, demand resources, DG and other endeavors that might affect energy usage, it is far from clear that implementing RD will actually yield any significant benefits. Utilities cannot easily ignore cost-effective measures between rate proceedings that would reduce energy use without facing risk of Department censure and rate-of-return penalties when their performance is reviewed by the Department, the Attorney General and other interested parties in a subsequent base rate proceeding. For this reason, the NASUCA Resolution suggests that Revenue Decoupling is not generally

²³ Revenue Decoupling: A Policy Brief of the Electricity Consumers Resource Council, January, 2007 (hereinafter "ELCON Brief"), pp. 5-8, available at <http://www.elcon.org/Documents/Publications/3-1RevenueDecoupling.PDF>.

²⁴ See Another Side to Decoupling: Share the Gain, Not the Pain, Public Utilities Fortnightly, August, 2007, p. 46.

needed to foster utility support for energy efficiency, as demonstrated by the fact that utilities have offered these programs for years and continue to enjoy robust financial health.²⁵

This view finds support in the experiences of electric utilities in the Commonwealth. Massachusetts electric utilities presently administer a variety of energy efficiency programs that are funded by the Systems Benefit Charge (“SBC”). These programs, which are overseen by the Division of Energy Resources (“DOER”), are available to all customer classes and include a variety of initiatives. Most notably, the programs: (1) provide funds to defray the cost of installing energy efficient lighting, air conditioning units, appliances and other equipment in new and existing residences and business facilities; (2) deliver educational programs and tools that encourage and enable customers to conserve energy; and (3) offer other technical assistance and support in furtherance of the Commonwealth’s efficiency goals.²⁶ DOER reports that these programs have been highly successful,²⁷ suggesting that utilities can do, and in fact have done, a good job at implementing conservation and energy efficiency programs within their control without the need for structural reforms associated with Revenue Decoupling. Absent evidence of a market failure, the Department should hesitate to order RD to solve a theoretical problem that may not exist in practice. But even if it could be proved that the utilities’ disincentive is interfering with their administration of energy efficiency and

²⁵ NASUCA Resolution, p. 2.

²⁶ Massachusetts Saving Electricity: A Summary of the Performance of Electric Efficiency Programs Funded by Ratepayers Between 2003 and 2005, Executive Office of Energy and Environmental Affairs, Massachusetts Division of Energy Resources, April 2, 2007 (hereinafter “DOER Report”), pp 8-10, available at http://www.mass.gov/Eoca/docs/doer/pub_info/ee03-05.pdf.

²⁷ Id. at 12.

other demand resources, there is no guarantee that RD would solve that problem because it does not create any positive incentive for utilities to promote these programs. At best, it simply removes a disincentive, thereby making the utilities indifferent to the issue.²⁸

Finally, even if one further assumes that RD will motivate the utilities to step up their performance on the energy efficiency and demand response fronts, it still may not yield significant benefits unless it is coupled with other legislative and regulatory reforms, such as increasing the statutory cap on the SBC,²⁹ restructuring standby rates charged to owners of DG units, and implementing dynamic pricing principles in order to send clear price signals to basic service customers, which would allow them to regulate their own electricity consumption and conservation decisions. The latter two measures are addressed in more detail in Section II below.

C. Revenue Decoupling Will Involve Significant One-Time and Continuing Administrative Costs that Should Not Be Incurred Absent Clear Proof of Offsetting Benefits.

The Proposal contemplates that the allowed revenue amounts will be set in a base rate proceeding to be conducted for each utility.³⁰ RESA agrees with that aspect of the Proposal because, as the Order properly notes, Department review of a full cost of service study is needed to ensure that going-in rates are just and reasonable and not discriminatory or preferential.³¹ Given the practical impossibility of conducting the required rate proceedings for all gas and electric utilities within the first six months after

²⁸ See ELCON Brief, p. 5.

²⁹ The Department may wish to recommend to the Legislature that the statutory cap on the SBC be raised as customer demand for the SBC-funded programs exceeds the utility's ability to meet that need. See DOER Report, p. 2.

³⁰ Order, pp. 10, 14.

³¹ Id. at 14.

implementation of Revenue Decoupling, the Department and the parties are likely to have to stagger the rate cases over a period of years. While critical to ensuring that the Revenue Decoupling mechanism for each Massachusetts utility will further, rather than harm, the public interest, such proceedings (which have been largely, but not entirely, avoided by the utilities in recent years through Department-approved settlement agreements), necessarily involve substantial costs for the utility, the Attorney General, other interested parties and the Department itself.

Moreover, the Department should not ignore the continuing administrative costs that would be imposed on public and private parties as a result of Revenue Decoupling. The process of preparing, filing and reviewing the true-up and other adjustment mechanisms on a quarterly and annual basis for each utility will be substantial and will also add significant administrative costs to the utilities and the Department. RESA recommends that the Department not impose these substantial costs on the affected parties without clear record evidence that the benefits of Revenue Decoupling will substantially exceed the significant apparent associated costs.

D. Revenue Decoupling Can Shift Excessive Risk to Ratepayers and Promote Mediocrity in the Management of Utilities.

In addition to the direct implementation costs imposed on public and private agencies, Revenue Decoupling involves significant risks that should be identified and accounted for by the Department in determining whether to proceed with an RD mechanism in the Commonwealth. For example, given the associated complexities discussed above in relation to the Proposal, it is far from clear that the Department will be able to ensure that the rates for each class adopted through a ratemaking process will be least cost in comparison to traditional ratemaking approaches. It also is unclear whether

the necessary alignments of utility returns with utility sales will accurately reflect cost causation principles in addressing the many factors that can cause volumetric throughput to fall. These include mild weather patterns, changing economic conditions, population shifts and energy efficiency and load reduction measures. Under the existing rate-making model, the utilities' shareholders bear the risk of declining sales due to all or most of these factors. By contrast, RD mechanisms shift these risks from the utilities' shareholders to their ratepayers by increasing distribution rates for losses realized by the utilities for all sales drops, irrespective of their cause.³²

RD could also promote mediocrity in the management of utilities. The primary duty of regulated utilities is to deliver electricity and gas to their customers at the lowest possible cost. The existing rate-making model nurtures that goal by encouraging utilities to manage their costs between rate cases as sales volumes rise and fall. By contrast, RD reduces that incentive because it immunizes utility earnings from sales fluctuations between rate proceedings.³³ RD would also reduce the utility's incentive to properly set distribution rates in the first place because of the promise of a true-up adjustment for differences between actual revenues collected from customers and the allowed revenues.

E. RD Could Actually Reduce Customer Incentives to Conserve Energy.

Most RD models, including the Proposal, contain a true-up mechanism that allows the utilities to adjust future distribution rates for the difference between actual revenues collected from their customers and the allowed revenue target. Under this approach, a customer who undertakes energy efficiency or load reduction measures will not realize a reduction in distribution costs, as it would under the existing rate-making

³² See ELCON Brief, pp. 5-6; NASUCA Resolution, pp. 2-3.

³³ Id. at 5-6.

model. That is because the decline in that customer's electricity or gas usage would cause the utility's actual sales to fall below the allowed revenue for the customer and, therefore, it would produce an increase in future distribution rates in the form of a true-up adjustment. At the same time, a customer who uses an excessive amount of gas or electricity will actually drive down distribution rates because the volumetric sales derived from that excess consumption would cause the actual revenues to rise above the allowed revenue for that customer. This perverse result could actually limit or remove incentives for customers to engage in energy conservation programs, undermining the whole purpose of RD.³⁴ Put another way, in removing utility disincentives to invest in conservation and demand response programs, a Revenue Decoupling mechanism may, in fact, create a new structural disincentive for customers to invest in these measures.

F. RD Could Undermine Product Innovation and the Ability of Competitive Suppliers to Offer Energy Efficiency Services to Their Customers.

As gas and electricity prices have risen in recent years, customers have sought out energy efficiency and load response programs in record numbers. In response to that need, competitive providers of gas and electricity supplies have added to their suite of products tools and services that allow customers to integrate these programs with their broader procurement and management strategies. This dynamic has spawned innovation in the marketplace to the benefit of Massachusetts consumers. If RD ultimately reduces customer incentives to engage in energy efficiency and load reduction measures, as discussed above, it will hinder that innovation and undermine the ability of competitive suppliers to deliver these desirable and socially-beneficial services to their customers.

³⁴ ELCON Brief, p 7 ("RD mechanisms undermine incentives for customers to invest in more efficient appliances and equipment because the reward for reducing consumption is higher rates in the future").

II. THE DEPARTMENT SHOULD UNDERTAKE OTHER EFFORTS THAT WILL INCREASE USE OF DEMAND RESOURCES IN TANDEM WITH THIS PROCEEDING.

Irrespective of whether the Department elects to implement some form of Revenue Decoupling at the conclusion of this proceeding, RESA is particularly concerned that the massive resources needed to consider and, if need be, implement a proposal with the complexity of Revenue Decoupling will divert the Department's attention from speedy implementation of other important policy initiatives. These proposals merit consideration and adoption in their own right and are needed for the Commonwealth to benefit from Revenue Decoupling if and when it is implemented by the Department.

A. The Department Should Proceed With the Dynamic Pricing Investigation at the Earliest Possible Date.

The Department's efforts to expand energy efficiency measures in Massachusetts must necessarily begin with the customers. Although customer education programs are helpful in this regard, the best way to encourage broad-scale energy conservation and investment in demand resources is to provide basic service customers with timely and accurate price signals through dynamic pricing techniques. While the eventual outcome of RD is unknown, it is clear that the generation costs of customer bills are far higher than the distribution costs. Thus, the most direct way to encourage customer conservation and efficiency is to adjust the pricing of basic service. The Department therefore should proceed expeditiously with the dynamic pricing investigation initiated in Docket 06-101 irrespective of whether it implements RD.

Under the existing basic service regime, customers are charged the same rate for each kilowatt hour (“kWh”) used regardless of when it is consumed. This average rate structure masks the significant hourly and seasonal variability inherent in marginal supply costs, as represented by the locational marginal prices at the wholesale level. Because customers do not see these price variations, they do not adjust their consumption in recognition of their perceived value of electricity as they do in markets for other goods and services where prices reflect the marginal cost of supply. As a result, customers are encouraged to consume more energy during peak periods than they would if they were charged the true cost of electricity.

In recognition of this flaw, late last year DOER petitioned the Department³⁵ to investigate implementation of basic service rates that would be based on dynamic pricing models (“DOER Petition”).³⁶ Specifically, DOER advocated that for large and potentially medium-sized commercial and industrial (“C&I”) customers, basic service pricing should be linked to hourly market prices, rather than the current system based on prices set every three months.³⁷ For residential and small C&I customers, DOER sought time-of-use pricing with peak and off-peak prices.³⁸ DOER explained that the energy efficiency produced by these dynamic pricing models will drive down wholesale electricity prices and improve the overall reliability and efficiency of the electric system,

³⁵ For simplicity, RESA refers to both the DPU and its predecessor agency, the Department of Telecommunications and Energy, as the “Department” in these Comments.

³⁶ Petition of DOER for an Investigation Into Dynamic Pricing for Basic/Default Service, October 31, 2006, Docket 06-101.

³⁷ Id. at 6.

³⁸ Id.

consistent with the goals expressed by the Department in its June 22 Order in this docket.

Specifically, DOER stated:

Dynamic pricing of basic service would encourage consumers to utilize electricity more efficiently, in better alignment with its true cost and value. These pricing regimes would enable them to save money by shifting consumption to off-peak periods, be more productive by using electricity during those off-peak periods, reduce the overall cost of electricity to all consumers during peak periods and reduce the cost to society of maintaining large amounts of resources in reserve to be used only rarely at peak consumption periods. Dynamic pricing would reduce or delay the need for new generation resources, especially peaking resources, foster more efficient use of existing generation resources, increase the proportion of demand resources competing economically in the marketplace, and foster the use of new technologies that would allow consumers to automate adjustments to their consumption so that it occurs when its actual value more closely aligns with their willingness to pay for it. In short, these pricing structures would create a more efficient and more productive electricity system for all ratepayers and for society.³⁹

On November 7, 2006, the Department initiated a docket to consider the DOER Petition, including the scope and procedures for a dynamic pricing investigation and, specifically, whether hourly pricing for large C&I customers should be addressed in an initial phase with dynamic pricing for residential and other C&I customers considered in a separate or later phase.⁴⁰ Pursuant to the Department's request, written comments were filed by RESA and approximately 20 other parties encompassing all segments of the Massachusetts electric industry (including large C&I customers). Virtually all of the commenting parties strongly supported the DOER Petition and made detailed

³⁹ Id. at 6-7.

⁴⁰ Notice of Filing and Request for Comment, November 7, 2006, p. 1. Docket 06-101.

recommendations regarding the best ways to implement dynamic pricing on a state-wide basis. The Department should proceed expeditiously with its dynamic pricing investigation because timely and accurate price signals in basic service rates are crucial to the Department's goals to increase energy conservation and efficiency, particularly during peak periods. Timely and accurate price signals will also provide societally-important benefits during the months (and likely years) in which any Revenue Decoupling mechanism is being debated and implemented and will likely enhance the beneficial impacts of any RD plan once it is implemented.

B. The Department Should Proceed With its DG Investigation.

On March 23, 2007, the Department on its own motion initiated an investigation into the ways by which the Commonwealth could increase investment in DG assets ("March 23 Order").⁴¹ The Department stated that its investigation would focus on the costs and benefits of DG resources, the appropriate ratemaking treatment for standby rates and other charges, and the proper role of the utility in facilitating the installation of DG resources.⁴²

With regard to rate structures, the March 23 Order stated that the Department would consider three potential mechanisms that could remove the utilities' disincentives to support the construction of new DG facilities, these being lost revenue recovery (though standby rates), monetary incentives, and revenue decoupling.⁴³ The Department should conduct this investigation in tandem with this proceeding because such approach: (1) will inform the Department as to whether the Proposal under review in this

⁴¹ Vote and Order Opening Investigation, March 23, 2007, Docket 07-6.

⁴² Id. at 1.

⁴³ Id. at 8.

proceeding would properly promote increased deployment of DG over the longer term; and (2) could spawn shorter-term investment in DG by adjusting the standby rates that are charged to owners of DG assets.

Conclusion

For the reasons discussed above, RESA reiterates its interest in the important issues raised by this docket. RESA requests that the Department: (1) carefully consider the benefits, costs and likely risks associated with Revenue Decoupling proposals prior to ordering implementation; and (2) not let the conduct of the instant proceeding distract the Department from reviewing pending dockets which further the same goals as the Department seeks to achieve in this proceeding and are needed to maximize benefits from Revenue Decoupling, if adopted, such as implementation of dynamic pricing and initiatives that would foster increased investment in DG.

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